

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Ackerman Analyst: Roger Lackey Bill Number: AB 189
Related Bills: AB 1694 (Stats. 1998, Ch. 80). Telephone: 845-3627 Introduced Date: 01-21-99
Attorney: Doug Bramhall Sponsor: Franchise Tax Board

SUBJECT: Clarify Authority To Suspend Disregarded Limited Liability Companies

SUMMARY

This bill would remove the erroneous reference to an LLC classified as a partnership in the definition of "tax" for purposes of suspending an LLC.

EFFECTIVE DATE

This bill would apply retroactively to taxable years beginning on or after January 1, 1997. The retroactive application would correspond to the effective date of prior legislation amending this section: SB 1234 (Ch. 608, Stat. 1997) and AB 1694 (Ch. 80, Stat. 1998).

SPECIFIC FINDINGS

Under **federal** law, a business entity is classified as either a "corporation per se," treated and taxed as a corporation, or an "eligible entity" entitled to elect its classification as follows:

- If the eligible entity has only one member, it may elect to be treated as a corporation or to be disregarded as an entity separate from its owner; or
- If the eligible entity has two or more members, it may elect to be classified and taxed either as a corporation or a partnership.

Any "eligible entity" that fails to make a proper election will be classified according to default classification rules:

1. With regard to domestic entities, an eligible entity with a single owner is disregarded as a separate entity;
2. An eligible domestic entity with two or more owners is classified as a partnership;
3. With regard to foreign eligible entities, an entity where all members have limited liability is classified as a corporation;
4. A foreign eligible entity with two or more owners is classified as a partnership if at least one member does not have limited liability; and
5. A foreign eligible entity with a single owner that does not have limited liability is disregarded.

Thus, for **federal** purposes, a corporate-owned, single-member limited liability company (LLC) that files a federal form 966 (Corporate Dissolution or Liquidation) is disregarded and, for tax purposes, effectively disappears and is treated as a division or branch of its corporate parent. An individually-owned single-member LLC that is disregarded is treated as a sole proprietorship.

Board Position:

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| <u>X</u> | S | <u> </u> | NA | <u> </u> | NP |
| <u> </u> | SA | <u> </u> | O | <u> </u> | NAR |
| <u> </u> | N | <u> </u> | OUA | <u> </u> | PENDING |

Department Director

Date

Gerald Goldberg

2/19/99

California law adopted federal law concerning the classification of business entities for tax purposes, with some minor modifications. In particular, the tax and fee previously imposed on an LLC classified as a partnership now apply to any LLC not classified as a corporation, including an LLC that is otherwise disregarded for federal and state tax purposes.

Under **existing state law**, the corporate powers, rights, and privileges of a domestic or foreign corporate taxpayer may be suspended or forfeited, respectively, if any portion of tax, penalties, or interest that is due and payable is not paid on or before certain dates, or if a required tax return is not filed. For purposes of this law, "taxpayer" includes any LLC that is organized in California or registered with the Secretary of State. However, while "tax" includes the tax and fee imposed by law with respect to an LLC not classified as a corporation, the statute limits the reference to the tax imposed on an LLC classified as a partnership for California purposes.

This bill would remove the erroneous reference to an LLC classified as a partnership in the definition of "tax" for purposes of suspending an LLC. Thus, clarifying that an LLC disregarded for tax purposes, which still owes the tax and fee, would be subject to suspension.

Implementation Considerations

Implementing this bill would not significantly impact the department's programs and operations.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact on the department's costs.

Tax Revenue Estimate

This bill would not have any identifiable impact on income tax revenue.

BOARD POSITION

Support.

At its December 16, 1998, meeting, the Franchise Tax Board voted to sponsor the language contained in this bill.